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Greece Redux: All Over Again?

by Alessandro Leipold

So, here we go again? Five years from the onset of the euro area crisis, triggered by fears radiating from Greece, concerns are again focused on Athens and the upcoming elections of January 25. The concerns parallel those of 2010: Grexit, debt repudiation, contagion to other peripheral countries – the scenario, in short, that plagued markets until Mario Draghi's "whatever-it-takes" of July 2012.

Markets continue to have faith in the ECB President's commitment. Pressures have thus been limited to Greek government bonds, with other public debt yields actually declining. Many pundits share the markets' benign assessment, contending that, this time, the problem is essentially Greek. But on what material basis does such confidence in crisis containment rest? As will be recalled, the tool at hand to block contagion is that of Outright Monetary Transactions (OMTs), i.e., ECB purchases of government bonds of countries under pressure. To date, the mere announcement of the instrument, without any actual interventions, has sufficed to abate tensions at a stroke and to keep pressures at bay for two and a half years.

Any renewed Greek crisis would test the effectiveness of this firewall, and could find it seriously wanting. First, OMTs are presently suspended in a legal limbo. The European Court of Justice has yet to examine the case, passed on by a highly skeptical German Constitutional Court, and determine the legality of the instrument. In such a situation, the ECB is in no position to intervene. It certainly cannot add fuel to the political fire surrounding possible QE, expected to be announced at the next ECB meeting, just a few days ahead of the vote in Greece.

There furthermore is a second, weighty obstacle to the deployment of OMTs: the fact that their use requires acceptance of a program – under the so-called Enhanced Conditions Credit Line (ECCL) – that until now all candidate countries have spurned. Indeed, underlying the current difficulties is Athens' insistence on a "clean" exit from the troika program – i.e., without a precautionary and conditional credit line – in the footsteps of Dublin and Lisbon.

But, one might ask, couldn't the expected quantitative easing suffice? After all, it too would involve purchases of sovereign bonds, furthermore without the need for a program, and thus easily acceptable by beneficiary countries. But while OMTs would be directed only toward countries under pressure, without quantitative limits, aiming to

normalize monetary conditions across the euro area, QE would be generalized and limited, and with a different objective (that of raising eurozone inflation).

In essence, OMTs appear in many ways to be a bluff, that so far no one has called and in which market participants still believe. Or at least they believe in the commitment – essentially of a political nature – to do “whatever it takes.” In this respect, Mario Draghi is right to argue (Il Sole of 31 December) that those who doubted the resilience of European monetary union underestimated its political dimension. Sure, monetary union is economically still incomplete, but its glue has been members' “willingness to come together to solve common problems when it mattered most.” So far, this political glue has worked, confounding the Cassandras who predicted the imminent demise of the euro. But can one continue to rely on it? Clearly less than till now. To begin with, according at least to Der Spiegel, Germany would now be ready to accept a possible Greek exit from the euro, seeing diminished risks of contagion. The report is unconfirmed, but another fact is indisputable: European politics are shifting from being EMU's glue to being a divisive force, with the future of the euro in the hands of voters – following Greece, also those from Spain and Portugal – now largely anti-european, albeit to varying degrees.

Much has of course changed since the outbreak of the crisis in 2010, but it would be a grievous mistake to discount the threats posed by flared-up tensions in Greece. It almost seems as if Syriza, with a softening of its tone, is more aware of this than the European leaders. On the contrary, they have continued to dodge the pledge, made in February 2012, to further reduce Greece's debt burden once a primary surplus was achieved. The eurozone should live up to this commitment, supplementing it with – more generally – a concrete application (for all countries) of the flexibility provided by the Stability and Growth Pact, starting with the exclusion of Juncker Plan investments from the calculation of the deficit. Only with concrete demonstrations of this type, combined with continued reform efforts in individual countries, will it be possible to continue to believe in “political will” as being able to hold monetary union together. There is in reality no other effective firewall to possible contagion from Athens. Beware of underestimating its risk.

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